

Report on Examination
of
Quality Health Plans, Inc.
Holiday, Florida
as of
December 31, 2006

By The
State of Florida
Office of Insurance Regulation

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Tallahassee, Florida

June 13, 2008

Kevin M. McCarty, Commissioner
Florida Office of Insurance Regulation
200 E. Gaines Street, Room 101
Tallahassee, Florida 32399-0301

Dear Sir:

Pursuant to your instructions, in compliance with Section 641.27, Florida Statutes (F.S.), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2006, of the financial condition and corporate affairs of:

Quality Health Plans, Inc.
2435 U.S. Highway 19, Suite 470
Holiday, Florida 34691

hereinafter referred to as the "Company." Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2004 through December 31, 2006. This was the first financial condition examination of the Company by the Florida Office of Insurance Regulation (the "Office").

Planning for the current examination began on October 1, 2007. The fieldwork commenced on October 15, 2007 and concluded on April 7, 2008. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This was a statutory financial condition examination conducted in accordance with the NAIC *Financial Examiners Handbook, Accounting Practices and Procedures Manual, and Annual Statement Instructions*, with due regard to the requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value, and integrity of the statement assets and the determination of liabilities, as they affect the Company's solvency.

The examination included a review of corporate and other selected records deemed pertinent to the Company's operations and practices. In addition, various ratio results, the Company's independent audit reports, and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the Company's assets and liabilities as reported by the Company in its 2006 annual statement. Transactions subsequent to December 31, 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which require special explanation or description.

After considering the Company's control environment and the materiality level set for this examination, we relied on work performed by the Company's CPA for the following accounts:

- Other amounts receivable under reinsurance contracts
- Commitments and contingent liabilities

HISTORY

GENERAL

The Company was incorporated in Florida on August 27, 2001, and commenced business on January 1, 2003.

As of the date of this examination, the Company was authorized to transact business as a health maintenance organization (HMO) in accordance with Part I of Chapter 641, F.S.

The Company's articles of incorporation were amended on June 5, 2007 to increase the number of authorized common stock shares from 10,000 to 700,000, and to increase the par value per common stock share from \$.01 to \$1.00. The Company's bylaws were not amended during the period covered by this examination.

CAPITAL STOCK

As of December 31, 2006, the Company's capitalization was as follows:

Number of authorized common capital shares	10,000
Number of shares issued and outstanding	100
Total common capital stock	\$1.00
Par value per share	\$0.01

At December 31, 2006, the Company was wholly-owned and controlled by Haider A. Khan, M.D. An abbreviated organizational chart appears on page 8.

PROFITABILITY

For the period of this examination, the Company reported the following:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Year-end enrollment	6,057	5,618	5,456
In millions:			
Net premiums	\$48.7	\$39.3	\$36.1
Total revenues	\$48.7	\$39.3	\$36.1
Net loss	\$6.7	\$2.5	\$1.0
Total capital and surplus (deficit)	(\$5.0)	\$1.6	\$1.2

DIVIDENDS

The Company did not pay shareholder dividends during the period of this examination.

MANAGEMENT

The annual shareholder meeting for the election of directors was held in accordance with Section 607.0701, F.S. Directors serving as of December 31, 2006 were:

Directors	
<u>Name and Location</u>	<u>Principal Occupation</u>
Haider A. Khan, M.D. Holiday, Florida	President - Quality Health Plans, Inc.
Nazeer H. Khan, M.D. Holiday, Florida	Chief Executive Officer - Quality Health Plans, Inc.
Sabiha H. Khan Holiday, Florida	Chief Operating Officer, Chief Financial Officer, & Chief Compliance Officer - Quality Health Plans, Inc.

The following were the Company's senior officers as of December 31, 2006, as appointed by its board of directors in accordance with the Company's bylaws:

Senior Officers	
<u>Name</u>	<u>Title</u>
Haider A. Khan, M.D.	President
Nazeer H. Khan, M.D.	Chief Executive Officer
Sabiha H. Khan	Chief Operating Officer, Chief Financial Officer, & Chief Compliance Officer

CONFLICT OF INTEREST PROCEDURE

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with Section 607.0832, F.S. No exceptions were noted during this examination.

CORPORATE RECORDS

The recorded minutes of the shareholder and Board of Directors meetings were reviewed for the period examined. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, F.S.

SURPLUS DEBT

As of December 31, 2006, the Company was obligated for surplus notes as follows:

Holder	Issued	Interest Rate	Amount
Delta Medical Care, Inc.	9/12/2005	8.0%	\$1,200,000
Delta Medical Care, Inc.	10/27/2005	8.0%	75,000
Haider A. Khan, M.D.	12/22/2005	8.0%	<u>380,000</u>
Total			<u><u>\$1,655,000</u></u>

The notes did not include maturity dates. They were approved by the Company's board of directors and the Office, and complied with the provisions of Rule 69O-191.088, Florida Administrative Code (F.A.C.). In accordance with Section 641.19(19), F.S., the surplus note debt was included in the Company's surplus.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), F.A.C. The Company did not file a holding company registration statement with the State of Florida, in violation of Section 628.801, F.S., and Rule 69O-143.046, F.A.C.

The following agreements were in force between the Company and its affiliates:

ADMINISTRATIVE SERVICES AGREEMENT

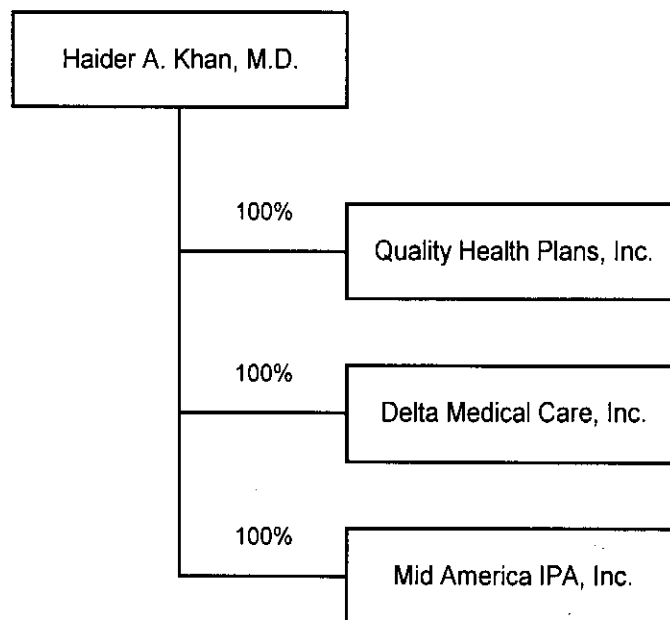
Delta Medical Care, Inc. provided to the Company claims administration, subscriber eligibility verification, and premium collection and administration services, pursuant to a February 21, 2002 agreement. Fees for the services were \$3.6 million, \$3.9 million, and \$1.9 million in years 2004, 2005, and 2006, respectively.

COMPREHENSIVE CAPITATION AGREEMENT

On December 1, 2002, the Company entered into a comprehensive capitation agreement with Mid America IPA, Inc., a physician provider network. Mid America IPA, Inc. contracted with primary care provider groups to provide primary care services to certain of the Company's members. Under the terms of the agreement, the Company was responsible for the applicable primary care provider group per member per month capitation charge. Fees for the services were \$620,460, \$800,718, and \$668,192 in years 2004, 2005, and 2006, respectively.

An abbreviated organizational chart as of December 31, 2006, reflecting the holding company system, is shown below. Schedule Y of the Company's 2006 annual statement did not disclose the names and interrelationships of the Company and all of its affiliates, as required by the NAIC *Annual Statement Instructions*.

**Quality Health Plans, Inc.
Organizational Chart
December 31, 2006**



FIDELITY BOND AND OTHER INSURANCE

The Company maintained acceptable levels of general liability insurance, in compliance with Rule 69O-191.069, F.A.C., and had a blanket fidelity bond in the amount of \$1 million, as required by Section 641.22, F.S. As an individual practice association (IPA) model HMO, the Company maintained adequate professional liability insurance. It required in its provider contracts that its providers certify and maintain appropriate levels of medical malpractice insurance or its equivalent in compliance with Rule 69O-191.069, F.A.C.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company provided eligible employees fringe benefits including group medical, long- and short-term disability, and dental insurance coverage, paid time off, and a Section 401(k) retirement plan.

STATUTORY DEPOSITS

The Company maintained on deposit with the Office an insolvency protection deposit of \$300,000 in accordance with Section 641.285, F.S., and a Rehabilitation Administrative Expense Fund deposit of \$10,000 in accordance with Section 641.227, F.S.

INSURANCE PRODUCTS AND RELATED PRACTICES

TERRITORY AND PLAN OF OPERATION

At December 31, 2006, the Company was authorized to transact business in Florida as an HMO in accordance with Part I of Chapter 641, F.S. It held a current health care provider certificate issued by the Florida Agency for Health Care Administration, pursuant to Part III of Chapter 641, F.S., valid until August 20, 2008.

The Company utilized telemarketers and employed sales representatives. It operated as an IPA and provided health care services solely to Medicare members. Its total membership at December 31, 2006 was 6,057.

The Company operated in the Florida counties of Charlotte, Citrus, Clay, Duval, Hernando, Hillsborough, Lake, Lee, Manatee, Marion, Orange, Osceola, Pasco, Pinellas, Polk, Sarasota, Seminole, St. Johns, Sumter, and Volusia.

TREATMENT OF MEMBERS

The Company established procedures for handling written complaints in accordance with Section 641.511, F.S., and maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

On January 1, 2006, the Company entered into a stop-loss reinsurance agreement with OneBeacon Insurance Company. The Company's retention limit was \$80,000 per member. Under the terms of the agreement, the reinsurer insured 90% of eligible facility costs in excess of \$80,000 for non-transplant services and organ/tissue transplants performed in contracted transplant facilities, and 50% of eligible facility costs in excess of \$80,000 for all other organ/tissue transplants, up to \$1 million per member. The agreement had not been approved by the Office, as required by Rule 69O-191.072, F.A.C.

The reinsurance agreement reviewed was found to comply with NAIC standards with respect to the standard insolvency and arbitration clauses, transfer of risk, and reporting and settlement information deadlines.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory-basis financial statements annually for years 2004, 2005, and 2006, pursuant to Section 641.26(1)(c), F.S.

The Company's accounting records were maintained on a computerized system. Its balance sheet accounts were verified with the line items of its annual statement submitted to the Office.

The Company's main administrative office was located in Holiday, Florida, where this examination was conducted.

The following agreements were in effect between the Company and non-affiliates:

INDEPENDENT AUDITOR AGREEMENT

The Company contracted with Thomas Howell Ferguson P.A. to audit its statutory-basis financial statements. Fees related to the agreement were \$43,768, \$36,431, and \$57,839 in years 2004, 2005, and 2006, respectively.

PHARMACY BENEFITS SERVICES AGREEMENT

ProCare RX provided pharmacy benefits management services to the Company pursuant to a December 27, 2004 agreement. The agreement was terminated by the Company effective August 31, 2007.

FINANCIAL STATEMENTS PER EXAMINATION

The following four pages contain statements of the Company's financial position at December 31, 2006, as determined by this examination, and the results of its operations for the year then ended as reported by the Company.

Quality Health Plans, Inc.
Assets
December 31, 2006

	Per Company	Examination Adjustments	Per Examination
Cash, cash equivalents and short-term investments	\$1,387,413	\$0	\$1,387,413
Amounts recoverable from reinsurers	258,242	0	258,242
Other amounts receivable under reinsurance contracts	36,207	0	36,207
Health care and other amounts receivable	7,492,001	0	7,492,001
Totals	<u>\$9,173,863</u>	<u>\$0</u>	<u>\$9,173,863</u>

Quality Health Plans, Inc.
Liabilities, Capital and Surplus
December 31, 2006

Liabilities	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$11,426,343	\$0	\$11,426,343
Aggregate health policy reserves	748,117	0	748,117
General expenses due or accrued	823,196	0	823,196
Liability for amounts held under uninsured plans	619,977	0	619,977
Aggregate write-ins for other liabilities	540,000	0	540,000
Total liabilities	<u>14,157,633</u>	<u>0</u>	<u>14,157,633</u>
Capital and Surplus			
Common capital stock	1	0	1
Gross paid in and contributed surplus	5,399,999	0	5,399,999
Surplus notes	1,655,000	0	1,655,000
Unassigned funds (deficit)	(12,038,770)	0	(12,038,770)
Total capital and surplus (deficit)	<u>(4,983,770)</u>	<u>0</u>	<u>(4,983,770)</u>
Total liabilities, capital and surplus	<u>\$9,173,863</u>	<u>\$0</u>	<u>\$9,173,863</u>

Quality Health Plans, Inc.
Statement of Revenue and Expenses
For The Year Ended December 31, 2006

Net premium income		\$48,670,333
Hospital and medical benefits	\$19,783,858	
Other professional services	2,320,562	
Outside referrals	660,214	
Emergency room and out-of-area	15,576,624	
Prescription drugs	7,964,158	
	<u>46,305,416</u>	
Net reinsurance recoveries	667,710	
Total hospital and medical	<u>45,637,706</u>	
Claims adjustment expenses	2,730,902	
General administrative expenses	7,197,025	
Total underwriting deductions		<u>55,565,633</u>
Net underwriting gain or (loss)		(6,895,300)
Net investment income		<u>164,138</u>
Net income (loss)		<u><u>(\$6,731,162)</u></u>

Quality Health Plans, Inc.
Capital and Surplus Account
For The Year Ended December 31, 2006

Capital and surplus - December 31, 2005		\$1,603,287
Net income (loss)	(\$6,731,162)	
Change in nonadmitted assets	(1,341,212)	
Paid in surplus	1,500,000	
Aggregate write-ins for gains (losses) in surplus	(14,683)	
Examination adjustments	<u>0</u>	<u>(6,587,057)</u>
Capital and surplus (deficit) - December 31, 2006		<u><u>(\$4,983,770)</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Cash and Securities

\$1,387,413

The Company was required by Section 641.35(9), F.S., to maintain an amount equal to its required minimum surplus in coin or currency of the United States on hand or on deposit in any solvent national or state bank, savings and loan association, or trust company or in eligible securities or obligations. At December 31, 2006, the total amount of the Company's cash and eligible securities was \$1,387,413, which was \$112,587 less than the required amount of \$1,500,000.

Unpaid Claims and Aggregate Health Policy Reserves

\$12,174,460

The Company's appointed actuary rendered an opinion that the amounts carried in the Company's balance sheet as of December 31, 2006 reasonably provided for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements. The Office actuary reviewed work papers provided by the Company and concurred with this opinion. Based on the results of the Office actuary's review and analysis of work papers and data provided by the Company, we concluded that the aggregate liability was not materially misstated.

Deficit

\$4,983,770

At December 31, 2006, the Company was insolvent and in violation of Section 641.225, F.S., which required it to maintain at all times minimum surplus in an amount that is the greater of \$1,500,000, 10% of its total liabilities, or 2% of its annualized premiums. At December 31, 2006, the Company's surplus was a deficit of \$4,983,770, which was \$6,483,770 less than its required minimum surplus of \$1,500,000. In May of 2007, the Company received \$6.7 million in additional contributed capital.

Quality Health Plans, Inc.
Comparative Analysis of Changes in Capital and Surplus
December 31, 2006

The following is a reconciliation of capital and surplus between that reported by the Company and as determined by the examination.

Capital and surplus (deficit), December 31, 2006 - per annual statement			(\$4,983,770)
	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Increase</u> <u>(Decrease)</u> <u>In Capital</u> <u>& Surplus</u>
Total assets	\$9,173,863	\$9,173,863	\$0
Total liabilities	\$14,157,633	\$14,157,633	<u>\$0</u>
Net change in capital and surplus			<u>0</u>
Capital and surplus (deficit), December 31, 2006 - per examination			<u><u>(\$4,983,770)</u></u>

SUMMARY OF FINDINGS

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2006.

Holding Company Registration Statement

As reported on page 7, the Company did not file a holding company registration statement with the State of Florida, in violation of Section 628.801, F.S., and Rule 69O-143.046, F.A.C. **We recommend that the Company comply with Section 628.801, F.S., and Rule 69O-143.046, F.A.C.**

Annual Statement Schedule Y

As reported on page 8, Schedule Y of the Company's 2006 annual statement did not disclose the names and interrelationships of the Company and all of its affiliates, as required by the NAIC *Annual Statement Instructions*. **We recommend that, in future statements filed with the Office, the Company correctly complete Schedule Y of its annual statement in accordance with the NAIC *Annual Statement Instructions*.**

Reinsurance Agreement

As reported on page 11, the Company's stop-loss reinsurance agreement with OneBeacon Insurance Company had not been approved by the Office, as required by Rule 69O-191.072, F.A.C. **We recommend that the Company comply with Rule 69O-191.072, F.A.C.**

Cash and Securities

As reported on page 18, the total amount of the Company's cash and eligible securities was \$1,387,413 as of December 31, 2006, which was \$112,587 less than the \$1,500,000 required by Section 641.35(9), F.S. **We recommend that the Company comply with Section 641.35(9), F.S.**

Minimum Surplus

As reported on page 18, at December 31, 2006, the Company was insolvent and in violation of Section 641.225, F.S., which required it to maintain at all times minimum surplus in an amount that is the greater of \$1,500,000, 10% of its total liabilities, or 2% of its annualized premiums. At December 31, 2006, the Company's surplus was a deficit of \$4,983,770, which was \$6,483,770 less than its required minimum surplus of \$1,500,000. In May of 2007, the Company received \$6.7 million in additional contributed capital. **We recommend that the Company maintain at all times the required minimum amount of surplus, in accordance with Section 641.225, F.S.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Quality Health Plans, Inc.** as of December 31, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's total capital and surplus was a deficit of \$4,983,770, which was not in compliance with Section 641.225, F.S. Its required minimum capital and surplus at December 31, 2006 was \$1.5 million. In May of 2007, the Company received \$6.7 million in additional contributed capital.

In addition to the undersigned, the following participated in this examination: Cathy S. Jones, CPA, Financial Examiner/Analyst Supervisor, Russell K. Judge, Financial Examiner/Analyst, and Richard Tan, Actuary.

Respectfully submitted,

Walter F. Banas, CIE, Financial Specialist
Florida Office of Insurance Regulation